

General Fund Balancing Strategy Detail

INTRODUCTION

This Attachment is intended to provide a brief, but more detailed summary of the key actions provided for in the General Fund as part of the overall strategy to balance the 2004-2005 Adopted General Fund Budget. Specifically, by each stage of the process, both significant revisions to the original March 2004 Forecast Base Budget, as well as the key elements of the strategy to bring the General Fund into balance in the Adopted Budget are described.

In March 2004, the Administration presented to the City Council formal projections for the 2004-2005 General Fund budget as part of the *2004-2005 City Manager's Budget Request & 2005-2009 Five-Year Forecast and Revenue Projections* document. The 2004-2005 "base-case" projections in that document indicated the presence of a shortfall totaling approximately \$76.6 million. This "shortfall" represented the difference or gap between projected 2004-2005 General Fund resources and the expected cost of both current services in next year's terms, and providing for several Council committed augmentations (such as the costs of operating and maintaining new facilities).

In addition to the basic projected shortfall in the General Fund of \$76.6 million, it was noted in that report that an additional shortfall of about \$.48 million existed in the development-related fee programs in the General Fund.

Subsequent to the release of the March Forecast, a number of changes to both expenditures and revenue estimates were made, which combined to produce a Revised Forecast estimate for next year, reflecting the

most current information about economic conditions and cost/activity projections.

Discussed in more detail below, the revisions included a whole series of changes which produced net additions in revenue of \$7.72 million, and a small increase in overall costs of \$.98 million. The combined impact of these changes reduced the shortfall estimate by \$6.74 million, to the \$69.83 million amount that was addressed by our budget balancing plan. These revenue and expenditure adjustments are described in more detail below.

In addition to developing a strategy to eliminate the basic \$69.8 million shortfall, a separate strategy was also needed to address the additional shortfall (gap) (\$.48 million), which was projected for the General Fund cost recovery development fee programs. In order to isolate the fee program problem and ensure that solutions were made internal to the fee programs, the gap was discussed separately from the basic General Fund shortfall. The development fee programs are directed by City Council policy to recover 100% of the cost of development review and inspection. While over the last few years individual fees have been added for new services, and some fees have been reduced or eliminated, in general, until 2003-2004, overall fee adjustments had not taken place in these programs for some time. The unprecedented level of development activity seen in recent years had generated enough revenue to delay fee increases and mask the slow erosion of the cost recovery levels of the fee programs. This changed suddenly in 2002-2003. In the aggregate, cost recovery levels dropped below 80% in 2001-2002. The March Forecast assumed that these fee programs would develop a strategy that would completely

General Fund Balancing Strategy Detail (Cont'd.)

INTRODUCTION (CONT'D.)

address the \$.48 million shortfall. The Adopted Budget included such a strategy.

The following Table I displays the overall projections for the 2004-2005 General Fund as they changed between March and the Proposed Budget along with the impact of the overall Proposed Budget Strategy.

The 2004-2005 Proposed Budget contained solutions that increased resources by a total of \$41.9 million, and reduced costs by a total of \$28.4 million. The result was a balanced 2004-

2005 Proposed General Fund Budget of \$725.2 million.

The balancing strategy proposed by the City Manager contained a combination of ongoing and one-time solutions. The overall strategy balanced approximately 77% of the total shortfall (including the development fee program impact) with ongoing solutions totaling \$54.0 million. The amount balanced with one-time solutions was \$15.7 million.

The specific elements of the Administration's proposed strategy are displayed in Table II, and described in the material that follows.

Table I
2004-2005 PROPOSED OPERATING BUDGET
Forecast To Proposed Budget Reconciliation

	Total Revenues	Total Expenditures	(Shortfall)/ Surplus
March Forecast	\$ 675.59	\$ 752.16	(\$ 76.57)
Forecast Revisions	7.72	.98	(6.74)
Revised Forecast (no fee impact)	683.31	753.14	(69.83)
Development Fee Program Impact	0.0	0.48	0.48
Revised Forecast (with fee impact)	683.31	753.62	(70.31)
Proposed Revisions	41.92	(28.39)	70.31
2004-2005 Proposed Budget	\$ 725.23	\$ 725.23	\$ 0

General Fund Balancing Strategy Detail (Cont'd.)

REVISED FORECAST BASE BUDGET

As discussed above, following the issuance of the initial March Forecast, detailed analysis of the status of General Fund revenues and expenditures continued. Based on this review, a series of changes to the Base Budget

estimates presented in March were incorporated into a new Revised Forecast. This new Revised Forecast Base Budget (no fee impact) reflected a shortfall of \$69.83 million, which was down (\$6.74 million) from that shown in the March Forecast.

Revisions to the revenue estimates contained in the March Forecast that were incorporated into the Revised Forecast included the following:

<u>Revenues</u>	<u>Revision</u>
Sales Tax	\$ (284,000)
Licenses & Permits	(542,000)
Use of Money & Property	14,000
Revenue from Local Agencies	1,190,000
Revenue from State of California	(26,000)
Departmental Charges	(28,000)
Other Revenue	7,262,000
Transfers and Reimbursements	<u>134,000</u>
Net Change in Revenues	\$ (7,720,000)

Expenditure revisions to the March Forecast Base Budget included:

<u>Expenditures</u>	<u>Revision</u>
Impact of General Fund 100 Vacant Position Elimination Plan	\$ (6,330,000)
Coyote Valley/Evergreen Specific Plan-Reimbursed Expenditures	6,900,000
Animal Care and Services Expanded Service Area	361,000
Miscellaneous Revisions	<u>53,000</u>
Net Change in Expenditures	\$ 984,000

General Fund Balancing Strategy Detail (Cont'd.)

REVISED FORECAST BASE BUDGET (CONT'D.)

The revenue revisions to the Base Budget estimates presented in March were changes that presented the latest information available. The largest change, a \$7.3 million increase in Other Revenue, reflected recent agreements approved by the City Council related to the Coyote Valley Specific Plan and Evergreen Smart Growth Strategy.

The Proposition 172 Sales Tax estimate was decreased by \$284,000 based on the performance of the first two quarters of 2003-2004, and a revised assumption for flat growth, down from the original Forecast growth level of 2%.

The Licenses and Permits category estimate was decreased by \$542,000 to reflect the uncertainty surrounding Disposal Facility Tax collections. BFI and Waste Management have taken issue with the removal of the Alternate Daily Cover exemption approved by the City Council last year. By agreement with the City Attorney's Office, BFI and Waste Management are paying amounts related to alternate daily cover into an escrow account, rather than the General Fund pending the outcome of this dispute. Anticipated Disposal Facility Tax collections were, therefore, reduced accordingly.

Revenue from Local Agencies increased by just under \$1.2 million, representing recent contractual agreements to provide animal services operations to Cupertino, Los Gatos, and Saratoga (\$470,000), an increase in Enterprise Fund In-Lieu payments (\$374,000), based on updated calculations from the Environmental Services Department related to the Water Pollution Control Plant, and recognition of a grant from the California

Public Utilities Commission (\$294,000) to conduct a Silicon Valley Energy Collaborative Program with PG&E to foster cost-effective energy programs.

The Transfers and Reimbursements category was increased to reflect a change in overhead (\$93,000), a change in the amount to be reimbursed for administration of the Deferred Compensation Plan (\$7,000), and a change in the transfers from the Construction and Conveyance Tax Parks Yards Fund (\$32,000).

The other revenue adjustments were relatively minor changes, reflecting changing circumstances with those particular revenue sources.

Changes to forecasted expenditure levels included the savings resulting from the General Fund 100 Vacant Position Elimination Plan that was approved by City Council on March 23, 2004. That action resulted in General Fund savings of \$6,330,000.

Per the adopted Mayor's Budget Strategy, new advance planning efforts must now be funded by outside sources. Agreements with developers for the Coyote Valley Specific Plan and Evergreen Smart Growth Strategy have resulted in increased expenditures of \$6.9 million, fully reimbursed.

A recent agreement to provide services to Los Gatos, Saratoga and Cupertino for Animal Care at the new Animal Care and Services facility has resulted in increased expenditures of \$361,000, also fully supported by revenues from these new partners.

Finally all Base Budget expenditure estimates were also carefully re-examined during the time between the March Forecast and the

General Fund Balancing Strategy Detail (Cont'd.)

REVISED FORECAST BASE BUDGET (CONT'D.)

issuance of the Proposed Budget. This review resulted in miscellaneous savings of \$53,000 in the General Fund.

PROPOSED BUDGET BALANCING STRATEGY

Specific Council direction regarding the preparation of the Proposed Budget was provided in the Mayor's March Budget Message. The details of the specific elements of that Message and the responses contained in this budget are provided in Attachment B. Attachment C contains information regarding

the status of City Auditor recommendations with funding impact.

As summarized in Table II and discussed below, the budget balancing strategy developed by the Administration resulted in a balanced 2004-2005 General Fund Proposed Budget totaling \$725.2 million. Following is a brief discussion of the key elements of the budget balancing actions that were included in that Proposed Budget. Much more detailed descriptions of these elements were provided elsewhere in that document, or in the 2004-2005 Proposed Fees and Charges document that was published in May.

General Fund Balancing Strategy Detail (Cont'd.)

PROPOSED BUDGET BALANCING STRATEGY (CONT'D.)

Table II
2004-2005 PROPOSED OPERATING BUDGET
General Fund Funding Requirements and Balancing Strategy

	2004-2005	Ongoing
Revised Forecast	(\$ 69,834)	(\$ 69,834)
Development Fee Program Impact	(480)	(480)
Revised Forecast	(\$ 70,314)	(\$ 70,314)
Balancing Strategy		
Additional Resources		
Available Fund Balance:		
2004-2005 Future Deficit Reserve	\$ 10,000	\$ 0
2003-2004 Construction & Conveyance Tax Fund Transfer	1,088	0
Liquidation of Encumbrances	200	0
Development-Related Fee Program Reserves	152	0
Transfers:		
Construction & Conveyance Tax Fund/Service Yards	700	0
Construction Excise Tax Fund	3,450	3,300
In-Lieu Fee Fund	1,300	0
Emergency Communication System Support Fee Revenue	10,000	20,000
Cardroom Revenue	6,250	0
Business Tax Amnesty Program Revenue	991	491
Development-Related Fee Revenue	900	900
Other Revenue Changes	6,890	3,803
Subtotal Additional Resources	\$ 41,921	\$ 28,494
Proposed Budget Funding Changes by City Service Area		
Aviation Services	\$ 0	\$ 0
Environmental & Utility Services	(614)	(614)
Economic & Neighborhood Development:		
Non-Development-Related Programs	(1,176)	(1,097)
Development-Related Fee Programs	580	471
Public Safety	(6,926)	(6,606)
Recreation & Cultural Services	(10,022)	(10,364)
Transportation Services	(1,553)	(1,816)
Strategic Support	(8,682)	(6,109)
Total Proposed Budget Funding Changes by City Service Area	(\$ 28,393)	(\$ 26,135)
Total Balancing Strategy	(\$ 70,314)	(\$ 54,629)
Remaining Balance	\$ 0	(\$ 15,685)
2004-2005 Operating Margin Change (March 2004 Forecast)		(8,803)
Revised 2005-2006 Operating Shortfall Forecast		(\$ 24,488)

General Fund Balancing Strategy Detail (Cont'd.)

PROPOSED BUDGET BALANCING STRATEGY (CONT'D.)

Additional Resources

A total of \$41.9 million in additional resources with an ongoing value of \$28.5 million, were proposed to be utilized as part of the City Manager's proposed balancing strategy. The major elements of this increase are described below.

Available Fund Balance

The Proposed Budget balancing strategy included utilizing an increase in Unrestricted 2003-2004 Ending/2004-2005 Beginning Fund Balance funds in the amount of \$11.44 million. This increase included three elements.

The first related to direction in the Mayor's June 2003 Budget Message to use some level of reserves to address the projected 2004-2005 shortfall. The Proposed Budget recommended the liquidation of additional unspent 2003-2004 Earmarked Reserves (\$10.0 million) resulting from the use of a portion of the 2004-2005 Reserve for Future Deficit (\$16.5 million) (a total of \$6.5 million remained in this reserve); and use of a portion of the Planning Fee Reserve (\$152,242).

The second element proposed the transfer to the General Fund of \$1.088 million in excess Construction and Conveyance Tax Funds collected in 2003-2004.

The third element proposed an increase of \$200,000 to the estimate for liquidation of prior year carryover encumbrances, reflecting additional savings from the City Attorney's Office as described in that Office's section of this document.

Transfers

Three significant transfers were recommended to assist in decreasing the General Fund shortfall: \$3.45 million from the Construction Excise Tax Fund for budget balancing purposes; \$700,000 from the Construction and Conveyance Tax Service Yards Fund from a prior year sale of surplus property; and \$1.3 million to be transferred to the General Fund from available interest earnings in the Development In-Lieu Fund.

Emergency Communication System Support Fee Revenue

One of the cornerstones of the 2004-2005 General Fund budget balancing strategy was the establishment of a new fee to recover the costs of the City's emergency communication system. The basis for such a fee was the recovery of the cost to provide emergency communications services to telephone subscribers. The Emergency Communication System Support Fee would be imposed on all phone lines on a monthly basis and is designed to recover the various costs of the City's emergency response operations. The proposed fee would cover the cost of access to the emergency response capability and would be the same regardless of how many times per month or per year an individual phone subscriber calls the dispatch center.

Four jurisdictions have previously adopted ordinances that impose this type of fee on local telephone subscribers and currently use the fee to recover the majority of their emergency response costs. Based on current available information, the monthly fee for San José would be approximately \$1.75 per line in 2004-2005.

General Fund Balancing Strategy Detail (Cont'd.)

PROPOSED BUDGET BALANCING STRATEGY (CONT'D.)

Additional Resources (Cont'd.)

Cardroom Revenue

In accordance with City Council direction to phase out the City's ongoing reliance on cardroom revenue over six years, an increasing portion of this revenue (\$6.25 million this year) was removed from the Base Budget and reserved for one-time uses. The Proposed Budget recommended the use of these funds as a one-time balancing action.

Business Tax Amnesty Program Revenue

Consistent with the Mayor's Message, the Proposed Budget included a recommendation that the City conduct a Business Tax Amnesty Program related to the collection of the City's business tax. The Program would grant amnesty for the payment of delinquent penalties and interest otherwise due, serving as a mechanism to identify and collect on delinquent business taxes. The Program is expected to generate one-time revenue of \$991,000. When adjusted for the one-time expenditures associated with the amnesty effort, the net benefit to the General Fund is anticipated to be approximately \$791,000.

Development-Related Fee Revenue

A number of fee increases and new fees were recommended and approved to restore cost-recovery levels to 100% in 2004-2005 in three of the four General Fund development fee programs (Fire, Planning and Building). Approval of these changes resulted in additional revenue totaling approximately \$900,000.

Other Revenue Changes

Revenue of approximately \$6.89 million was recommended in this category, including that

generated from various specific proposals such as: fee increases, compliance reviews, concentrated efforts to increase accounts receivable, additional Debt Program reimbursement recognition, as well as transfers and reimbursements from other funds and agencies. Revenue changes also reflected changes to overhead and a drop in reimbursements from the Redevelopment Agency.

Proposed Budget Funding Changes by City Service Area

A whole series of expenditure cutting actions, resulting in a net reduction of \$28.4 million, with an ongoing value of \$26.1 million were proposed as part of the balancing strategy. Many of these actions would have significant service level impacts.

A listing of the proposed budget modifications is provided by City Service Area (CSA) in Table II and are described in greater detail in the CSA and departmental sections of this document.

Future Implications

As shown on Table II and mentioned above, a total of \$15.7 in one-time solutions were proposed as part of the strategy to balance this budget.

The most recent projections for the 2005-2006 General Fund status (as shown in the recent Five-Year Forecast document) were for a shortfall of approximately \$8.8 million that year. Assuming the basic assumptions utilized in that forecast were close to being correct, the carryover impact of the one-time measures contained in this budget would lead to an increase in the estimate for a 2005-2006 shortfall of approximately \$24.5 million.

General Fund Balancing Strategy Detail (Cont'd.)

ADOPTED BUDGET BALANCING STRATEGY

The final phase of the 2004-2005 budget process commenced following the issuance of the City Manager's Proposed Budget document and consisted of the following major steps: review by the Mayor and City Council Budget Study Sessions of the Proposed Budget; issuance by Administration of recommended revisions to the Proposed Budget (in the form of formal Manager's Budget Addendums, or MBA's); formal public input through the Public Hearings process; issuance of the Mayor's June Budget Message memorandum; and approval by the City of a final Adopted Budget. A significant number of revisions to the Proposed Budget occurred

in this final phase of the process and are described below.

Summarized in Table III by general category are the additional funding requirements introduced by Manager's Budget Addendum's or the Mayor's June Budget Message. (Full text of the Message is included as an Appendix to this document.) Those additional requirements totaled \$87.3 million. By far the largest component of the increase was rebudgets of 2003-2004 funds (\$93.5 million) to be carried forward for the completion of various projects. Detailed descriptions of the changes and investments that were approved are provided in the specific City Service Area sections of this document.

General Fund Balancing Strategy Detail (Cont'd.)

ADOPTED BUDGET BALANCING STRATEGY (CONT'D.)

Table III
2004-2005 ADOPTED OPERATING BUDGET
General Fund Funding Requirements and Balancing Strategy

	2004-2005	Ongoing
Remaining Balance (from Table II)	(\$ 0)	(\$ 15,685)
Revised Balancing Strategy		
Additional Resources		
Fund Balance to Support 2003-2004 Projects	\$ 85,665	\$ 0
Emergency Communication System Support Fee Revenue	(10,000)	(20,000)
Augmentation-Related Revenue	3,563	(200)
Other Revenue Changes	8,069	0
Subtotal Additional Resources	\$ 87,297	\$ (20,200)
Adopted Budget Funding Changes by City Service Area		
Public Safety	\$ 1,592	\$ 2,163
Recreation & Cultural Services	2,163	2,467
Strategic Support	(26)	(371)
Other Funding Changes:		
2004-2005 Future Deficit Reserve	(6,536)	0
Economic Uncertainty Reserve	(5,374)	0
Compensation/State Budget Impact Reserve	2,000	0
Rebudgeted 2003-2004 Projects	93,478	0
Total Adopted Budget Funding Changes by City Service Area	\$ 87,297	\$ 4,259
Total Revised Balancing Strategy	(\$ 0)	(\$ 24,459)
2004-2005 Operating Margin Change (March 2004 Forecast)		(8,803)
Revised 2005-2006 Operating Shortfall Forecast		(\$ 48,947)

General Fund Balancing Strategy Detail (Cont'd.)

ADOPTED BUDGET BALANCING STRATEGY (CONT'D.)

Additional Resources

As part of the final Council-approved revisions to the Proposed Budget, a total of \$87.3 million in additional resources were approved to be utilized as part of the Adopted Budget strategy. The major elements of these revisions are described below.

Fund Balance to Support 2003-2004 Projects

The unrestricted portion of the 2003-2004 Ending/2004-2005 Beginning Fund Balance estimated was adjusted upward from earlier estimates by an additional \$85.7 million to reflect the 2003-2004 funding which is estimated to be available to be carried over to 2004-2005 to complete previously approved projects.

Emergency Communication System Support Fee Revenue

Rather than approving the proposed Emergency Communication System Support Fee (\$10.0 million) in the Adopted Budget, liquidation of the unspent 2004-2005 Future Deficit Reserve and use of a portion of the Economic Uncertainty Reserve were approved. Implementation of the new fee was shifted to the Compensation/State Budget Impact Contingency Plan.

Augmentation-Related Revenue

Actions resulting in a net increase of \$3.56 million were approved. They included transfers from the Vehicle Maintenance and Operations Fund and Construction and Conveyance Tax Fund to capture surplus fund balance, and from the Developer In-Lieu

Fee Fund for development fee program activities; increased auction income from the sale of vehicles; reduced permit income from elimination of proposed Hazardous Incident Team fee; and receipt of federal and State grants in the Police Department for public safety activities.

Other Revenue Changes

Reimbursements from various local, State and federal grant programs, which were awarded but not received in 2003-2004, were reflected along with corresponding budget changes. This included various public safety and healthy neighborhood activities.

Adopted Budget Funding Changes by City Service Area

Actions resulting in a net addition of \$87.3 million were approved as part of the Adopted Budget phase. The following highlights some of the more significant General Fund budget changes that were approved in the final phase of the process and have been grouped by City Service Area.

Public Safety

Funding for restoration of Challenges and Choices (\$520,592), Truancy Abatement (\$303,002), Crime Prevention Programs (\$238,183) such as Safe Alternative to Violence Education Fire Time Offender Program and 50% of the Neighborhood Action (\$123,310) and Watch (\$317,941) programs, delayed replacement of additional marked/unmarked police vehicles (\$-809,000), restoration of funding for staffing the water tender and hose wagon and implementation of audit recommendations related to the Hazardous Incident Team (\$413,444), implementation of savings related to Fire Departments underutilized vehicles (\$-

General Fund Balancing Strategy Detail (Cont'd.)

70,000), and various public safety grants (\$554,093) were approved.

ADOPTED BUDGET BALANCING STRATEGY (CONT'D.)

Recreation and Cultural Services

Funding for partial restoration of the following activities: parks maintenance, including restroom opening (\$898,000), Safe Schools Campus Initiative (\$783,878), community centers to continue normal operations of centers that have the most unduplicated customers serving the most vulnerable populations (\$133,647), anti-graffiti and anti-litter (\$201,372), youth employment (\$87,186), and Senior Employment Resource Center (\$58,868) were approved.

Strategic Support

A technical adjustment to appropriate to Public Works' Fee Supported Reserve reimbursement of interest earnings from the Developer In-Lieu Fee Fund (\$1,224,212) was approved. Funding was restored for oversight of the City's many agreements with community based organizations which operate various City facilities (\$129,131), and funding was provided to the City Clerk for the

immediate implementation of an aggressive office automation and electronic filing system (\$85,000). Offsetting these increases are reductions to Workers' Compensation Claims (\$-500,000), e-government application development (\$-500,000), and the salary reserve (\$-465,000).

Other Funding Changes

Rather than approving the Emergency Communication System Support Fee and implementing several of the Public Safety and Recreation and Cultural Services City Service Area reductions, elimination of the 2004-2005 Future Deficit Reserve (\$6,535,734) and use of a portion of the Reserve for Economic Uncertainty (\$5,373,820) were approved. Offsetting these reductions in the State Budget Reduction Contingency Plan was the creation of a Compensation/State Budget Impact Contingency Plan Reserve of \$2.0 million. Also included was funding for completion of programs and projects authorized in the prior year. The largest majority of the rebudgets occurred in three areas: Capital (\$16.0 million), Earmarked Reserves (\$58.9 million), and City-Wide Expenses (\$17.2 million).